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Free Enterprise - Legality of Requirements Contract Under Section 3 of the Clayton Act

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FREE ENTERPRISE — LEGALITY OF REQUIREMENTS CONTRACT UNDER SECTION 3 OF THE CLAYTON ACT

Plaintiff, a public utility furnishing electric energy to an area adjacent to and including the City of Tampa, supplied power to approximately eleven percent of the population of the State of Florida. In 1955, the plaintiff company decided to expand its facilities by constructing another plant which was to consume coal as fuel, instead of the fuel oil which plaintiff, like most other utilities in the State of Florida, had previously utilized in its plants.[1] Pursuant to this decision, plaintiff contracted with defendant for the supply of coal, the contract calling for delivery to begin in 1957. The contract provided that the amount purchased by the plaintiff would never be below 225,000 tons per year, although it was estimated that the amount used would increase to approximately 2,250,000 tons per year. Defendant coal company was one of some 700 producers in the Appalachian Coal Area who were in a position to serve the Tampa market. Before the proposed date of delivery, defendant notified the plaintiff that it would not perform because in its opinion the contract was violative of the anti-trust laws.[2] After securing another supply for its coal requirements on a temporary basis, the plaintiff petitioned for a declaratory judgment holding the contract not violative of the anti-trust laws.[3] The district court granted summary judgment[4] for defendant on the ground that the contract was illegal under Section 3 of the Clayton Act; the court of appeals affirmed.[5] On writ of certiorari to the United States Supreme Court, *held*, reversed. As the contract only foreclosed approximately 1% of the relevant market involved, Section 3 of the Clayton Act[6] was not violated because a substantial share of

1. The Court stated that "every electrical generating plant in peninsular Florida burned oil at the time" of the consummation of the contract. Tampa Electric Co. v. Nashville Coal Co., 81 Sup. Ct. 623, 625 (1961). A 1958 estimate of the consumption of coal in the peninsular Florida area showed that the rate of consumption was 700,000 tons annually, and the record indicated that the plaintiff's consumption would equal that amount in 1959 and 1960, and would thereafter increase to a maximum figure of "about 2,250,000 tons annually." *Ibid.*

2. The defendant claimed that the contract was invalid under the provisions of Section 3 of the Clayton Act of 1914, 15 U.S.C. § 14 (1952), quoted in part at note 6 *infra*, Tampa Electric Co. v. Nashville Coal Co., 168 F. Supp. 456, 459 (M.D. Tenn. 1958).

3. The suit was instituted pursuant to the provisions of 28 U.S.C. § 2201 (1952).

4. On defendant's motion, Tampa Electric Co. v. Nashville Coal Co., 168 F. Supp. 456 (M.D. Tenn. 1958).

5. Tampa Electric Co. v. Nashville Coal Co., 276 F.2d 766 (6th Cir. 1960) (dissent by Weick, J.).

6. "It shall be unlawful for any person engaged in commerce, in the course

the relevant market was not foreclosed. *Tampa Electric Co. v. Nashville Coal Co.*, 365 U.S. 320 (1961).

When it became apparent that the Sherman Act of 1890 was ineffective in coping with many restraints of trade because of its very broad terms and the elusive "rule of reason" which the courts used in interpreting the statute,[7] Congress enacted the Clayton Act of 1914. This legislation was designed to eliminate ambiguities urged as defenses under the prior law, and was specifically aimed at some of the more frequent restraints of competition such as exclusive dealing, mergers, and price discrimination.[8] However, the Clayton Act was not free from ambiguities, particularly with regard to Section 3 concerning exclusive dealing.[9] Much confusion has been engendered by the part of the section referred to as the "competitive impact clause," which states that exclusive dealing is prohibited where the "effect . . . may be to substantially lessen competition or tend to create a monopoly."[10]

Early cases interpreting Section 3 noted that Congress did not intend to reach "every remote lessening of competition," but

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of such commerce, to lease or make a sale or contract for sale of goods . . . for use, consumption, or resale within the United States . . . on the condition, agreement, or understanding that the lessee or purchaser thereof shall not use or deal in the goods . . . of a competitor or competitors of the . . . seller, where the effect of such lease, sale, or contract for sale or such condition, agreement, or understanding may be to substantially lessen competition or tend to create a monopoly in any line of commerce." 15 U.S.C. § 14 (1952).

7. The case which is credited as having given birth to the "rule of reason" as a rule of interpretation of the Sherman Act of 1890 was that of Standard Oil Co. v. United States, 221 U.S. 1 (1911). For further enunciation of the rule of reason, see Chicago Board of Trade v. United States, 246 U.S. 231, 238 (1918): "The true test of legality is whether the restraint imposed is such as merely regulates and perhaps thereby promotes competition or whether it is such as may suppress or even destroy competition. To determine that question the court must ordinarily consider the facts peculiar to the business to which the restraint is applied. . . . The history of the restraint, the evil believed to exist, the reason for adopting the particular remedy, the purpose or end sought to be attained, are all relevant facts . . . . knowledge of intent may help the court to interpret facts and to predict consequences." See also Appalachian Coals, Inc. v. United States, 288 U.S. 344, 359-60 (1933); United States v. American Tobacco Co., 191 Fed. 371, 389 (S.D.N.Y. 1911).

8. Schwartz, *Potential Impairment of Competition—The Impact of Standard Oil Co. of California v. United States on the Standard of Legality Under the Clayton Act*, 98 U. PA. L. REV. 10 (1950). President Wilson had personally called for the law to be drafted "in such terms as will practically eliminate uncertainty." NEALE, THE ANTITRUST LAWS OF THE U.S.A. 186 (Cambridge 1960).

9. The House Judiciary Committee reported in 1914 that the measure treating of exclusive dealing, Section 3 of the act, "has apparently been much misunderstood, and great confusion seems to have arisen in regard to its provisions." H.R. Rep. No. 627, 63rd Cong., 2d Sess. 10-11 (1914). For fuller discussion of the legislative history of this provision, See Hodson, EXCLUSIVE DEALING, published in VAN CISE & DUNN, HOW TO COMPLY WITH THE ANTITRUST LAWS 140 (1954), and NEALE, THE ANTITRUST LAWS OF THE U.S.A. 185-88 (Cambridge 1960).

10. 15 U.S.C. § 14 (1952).

only that lessening of competition which may be said to be "substantial."[11] Such an explanation was apparently due to a realization that not all such agreements were aimed at stifling of competition, but that valid and justifiable business considerations might be served by certain exclusive arrangements.[12] However, delineation between a contract involving a "remote lessening of competition" not in violation of Section 3 and one which results in "substantial lessening of competition" has proved to be difficult.

The early rule was that if the practical effect of the contract was to prevent competition in a given market area, it violated the provision under consideration, if there was some showing of competitive injury.[13] A finding that the seller held a dominant position in the market would be sufficient to support an inference that competition would be adversely affected by the contract.[14]

The main practices which Section 3 seeks to regulate are the "requirement contract" and the "tying arrangement." A tying arrangement results when a supplier furnishes a product over which he has a measure of market control, but on the condition that the buyer take with this "controlled product," a "tied product" which would be easily available from the competitors of the supplier. An example of this sort of transaction would be where a manufacturer of computing machinery requires the buyers of his machine also to purchase the cards to be used in the machine. There seems to be general agreement with the observation that this kind of agreement serves "hardly any purpose beyond the suppression of competition,"[15] and the usual defense of protection of good will of the controlled product is rarely presented to any avail.[16]

11. *E.g.*, Standard Fashion Co. v. Magrane-Houston Co., 258 U.S. 346, 356-57 (1922).

12. Discussions of the benefits which may be produced by the requirements contract, and its concomitant economic and legal ramifications, may be found in the following: Lockhart & Sacks, *The Relevance of Economic Factors in Determining Whether Exclusive Dealing Arrangements Violate Section 3 of the Clayton Act*, 65 HARV. L. REV. 913 (1952); McLaren, *Related Problems of "Requirements" Contracts and Acquisitions in Vertical Integration Under the Anti-Trust Laws*, 45 ILL. L. REV. 141 (1950); Sotckhausen, *The Commercial and Anti-Trust Aspects of Term Requirements Contracts*, 23 N.Y.U.L.Q. REV. 412 (1948).

13. United Shoe Machinery Corp. v. United States, 258 U.S. 451 (1922).

14. Standard Fashion Co. v. Magrane-Houston Co., 258 U.S. 346 (1922).

15. Standard Oil Co. v. United States, 337 U.S. 293, 305 (1949).

16. See, *e.g.*, the answer to the defense of protection of good will in International Business Machines Corp. v. United States, 298 U.S. 131, 139-40 (1936): "Appellant is not prevented from proclaiming the virtues of its own cards or

A requirement contract is one in which the buyer contracts with a supplier to purchase whatever his requirements for the product may be within a given time period, usually with a maximum quantity established. There are several plausible reasons why a businessman might want to enter into this type of agreement with his customers other than a desire to foreclose competition. Some of the reasons most often advanced are: protection against future price increases, elimination of much of the risk and expense of storage of surplus supplies, and more accurate long-term planning on the basis of known costs.[17]

In 1947, the Supreme Court, in a case involving a tying arrangement, *United States v. International Salt Co.*,[18] espoused the rule that there is no need for a full economic analysis in order to determine whether or not a tying arrangement had transgressed the terms of Section 3, as long as it is established that the amount of the business affected was not "insignificant or insubstantial."[19] Two years later, in the celebrated *Standard Stations* case,[20] the Court carried this rule into the area of requirements contracts, and announced the rule which is now referred to as the "quantitative substantiality" doctrine for the interpretation of Section 3. This doctrine was explained by the Court as requiring at least some proof that "competition has been foreclosed in a substantial share of the line of commerce affected."[21] The Court rejected the contention that it should require a fuller examination of economic considerations in requirements contract cases than it had required in the tying arrangement cases. Mr. Justice Frankfurter explained in the majority opinion that such a criterion would require extensive economic evaluations for which courts were not equipped.[22] The *Standard*

warning against the danger of using, in its machines, cards which do not conform to the necessary specifications, or even from making its leases conditional upon the use of cards which conform to them." See also International Salt Co. v. United States, 332 U.S. 392 (1947); United Shoe Machinery Corp. v. United States, 258 U.S. 451 (1922). However, the defense will prevail in certain special circumstances. Such was the case in United States v. Jerrold Electronics Corp., 187 F. Supp. 545 (E.D. Pa. 1960), *aff'd per curiam*, 365 U.S. 567 (1961), a situation in which the defendant was a relative newcomer to the field of antenna systems which, in many cases, had to be produced on a "custom made" basis. The court held that the defense of protection of good will was valid, at least for the formative period of the company's business.

17. These purposes were recognized in the majority opinion of Standard Oil Co. v. United States, 337 U.S. 293, 306-07 (1949) (hereinafter referred to as *Standard Stations*).

18. International Salt Co. v. United States, 332 U.S. 392 (1947).

19. *Id.* at 396.

20. Standard Oil Co. v. United States, 337 U.S. 293 (1949).

21. *Id.* at 314.

22. The majority felt that this would be a "standard of proof, if not virtually

Stations decision has been criticized for the inflexibility of its rule and for refusing to recognize the inherent differences between a tying arrangement and a requirements contract.[23]

In addition to arousing criticism, the application of such a rigid rule to the area of requirements contracts created problems in the enforcement of Section 3. While the strict "quantitative substantiality" rule has been followed by the courts,[24] the Federal Trade Commission has, in several cases, demonstrated reluctance to follow the rule.[25] This attitude was given expression in the *Maico* case, in which the Commission stated it could not conclude that "evidence of the effect of an exclusive dealing agreement on competition is immaterial in a Federal Trade Commission proceeding alleging violation of Section 3 of the Clayton Act."[26]

To measure the "substantiality" of the competitive injury caused by a supplier, a determination of the "area of effective competition" or the "relevant market" of the supplied product must be made.[27] Also important is the "line of commerce" with which the contract is concerned, *i. e.*, the product for which the competitive injury is to be ascertained. The reason given for reversal in the instant case was the failure of the lower courts to make a finding as to the relevant market of effective competition. Both the lower courts assumed that the area of effective competition was merely peninsular Florida, but the Court decided that it did "not believe that the pie will slice so thinly,"[28]

impossible to meet, at least most ill-suited for ascertainment by courts." *Id.* at 310.

23. One writer criticized the decision as "bordering on *per se illegality*." Johnson, *Some Twilight Zone Antitrust Problems*, 1 ANTITRUST BULLETIN 615, 624 (1956). Similar characterizations of the rule of quantitative substantiality may be found in NEALE, THE ANTITRUST LAWS OF THE U.S.A. 194 (1960) ; Robinson, *Restraints on Trade and the Orderly Marketing of Goods*, 45 CORN. L.Q. 254, 276 (1960), and ATTORNEY GENERAL'S NATIONAL COMMITTEE ANTITRUST REPORT 147 (1955).

24. Dictograph Products, Inc. v. Federal Trade Commission, 217 F.2d 821 (2d Cir. 1954), *cert. denied*, 349 U.S. 940 (1955) ; Anchor Serum Co. v. Federal Trade Commission, 217 F.2d 867 (7th Cir. 1954) ; United States v. Sun Oil Co., 176 F. Supp. 715 (E.D. Pa. 1959).

25. Harley-Davidson Motor Co., 50 F.T.C. 1047 (1954) ; Anchor Serum Co., 50 F.T.C. 681 (1954) ; Maico Co., 50 F.T.C. 485 (1953).

26. Maico Co., 50 F.T.C. 485, 487 (1953).

27. United States v. E. I. duPont de Nemours & Co., 353 U.S. 586 (1957). See also, for a work dealing specifically with the problems engendered in the determination of the market, Comment, 54 COLUM. L. REV. 580 (1954). It is interesting that the author of this article took the rule of *Standard Stations* to be so strict as to foreclose any consideration of the "relevant market." "Consequently, the application of Section 3 does not require analysis of the market concept." *Id.* at 584. The instant case makes it clear that an analysis of the relevant market is a necessity in exclusive dealing cases.

28. Tampa Electric Co. v. Nashville Coal Co., 81 S.Ct. 623, 630 (1961).

and defined the relevant market as a seven-state area. When the anticipated coal requirements of the plaintiff were compared with the amount of coal furnished out of this area, the resultant percentage figure was less than 1% — "conservatively speaking, quite insubstantial."[29]

The instant case points up the extremely important place occupied by a correct determination of the relevant market in which a given product competes. It may be even more valuable in the future, however, because of some statements in the opinion which seem to indicate that the Court may reconsider its position in *Standard Stations.* This inference is premised upon a passage in the Court's opinion in which it inferred that it may weigh valid business purposes before invalidating requirements contracts under Section 3.[30] The Court also quoted favorably from the parts of the opinion in *Standard Stations* which recognized desirable features of requirements contracts.[31] The instant case may well provide a laudable and sorely needed element of flexibility in the application of Section 3 to requirements contracts, and will help bring the judicial standard of legality under this provision closer to that which has been administratively employed for some time.

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TORTS — AUTOMOBILE GUEST PASSENGERS — CONTRIBUTORY NEGLIGENCE AS BAR TO RECOVERY FROM THIRD PARTIES

Plaintiff sued to recover for personal injuries resulting from a collision involving an automobile in which he was a guest passenger and a bus owned by the defendant. The plaintiff and his host had been drinking together before the accident occurred. The court of appeal of Louisiana found the negligence of plain-

29. *Id.* at 631. The Court in this case did not make a determination of the line of commerce affected by the contract because of its disposition of the relevant market question. Rather, it assumed that it was bituminous coal.

30. The passage under consideration is: "In judging the term of a requirements contract in relation to the substantiality of the foreclosure of competition, particularized consideration of the parties' operations are not irrelevant." *Id.* at 632. Another statement of interest: "[A]t least in the case of public utilities the assurance of a steady and ample supply of fuel is necessary in the public interest." *Ibid.*

31. *Id.* at 631.